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Nos. 238 and 251

In the Supreme Court of the United States

OCTOBER TERM, 1941

THE UNITED STATES OF AMERICA, PETITIONER

v.

STATE OF NEW YORK

STATE OF NEW YORK, PETITIONER

v.

THE UNITED STATES OF AMERICA

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT
COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES

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OPINIONS BELOW

The second opinion of the District Court for the Western District of New York (R. 7-11) is unreported; its first opinion is reported in 28 F. Supp. 428. The opinion of the Circuit Court of Appeals (R. 15-20) is reported in 118 F. (2d) 537.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on April 12, 1941 (R. 21). The petition of the United States for a writ of certiorari, No. 238, was filed on July 5, 1941. The petition of the State of New York for a writ of certiorari, No. 251, was filed on July 9, 1941. Both were granted on October 13, 1941. The jurisdiction of this Court rests upon Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED**No. 238**

1. Whether the liability of an employer under Section 802 of the Social Security Act to pay the tax levied upon the income of an employee under Section 801 of that Act is a liability for "taxes" and is therefore entitled to priority of payment in bankruptcy within the meaning of Section 64 (a) (4) of the Bankruptcy Act.

No. 251

2. Section 901 of the Social Security Act imposes a tax upon employers and Section 902 permits a credit against that tax (not exceeding 90% thereof) on account of contributions made by the employer to state unemployment compensation funds. Where the assets of a bankrupt employer are

insufficient to meet the Federal and state claims in full, how shall the assets be distributed?

3. Whether any part of the tax imposed by Section 901 of the Social Security Act is a penalty not provable in bankruptcy within the meaning of Section 57 (j) of the Bankruptcy Act.

STATUTES AND REGULATIONS INVOLVED

The pertinent statutes and regulations are set forth in the Appendix, *infra*, pp. 27-32.

STATEMENT

The Independent Automobile Forwarding Corporation was adjudicated a bankrupt in the District Court for the Western District of New York on April 26, 1938 (R. 1). The liquidation of the property in the bankruptcy proceeding brought into the hands of the trustee assets of \$3,053.20, which are insufficient to pay in full the claims filed and allowed priority under Section 64 of the Bankruptcy Act (R. 5, 7-8).¹ The trustee accordingly filed a petition requesting instructions (R. 4-5). Priority claims of the United States and the State of New York are so large as to absorb the entire amount remaining in the hands of the

¹The statement under Rule 13 (R. 1) indicates that the claims of the United States aggregate \$7,344.11, whereas the opinion and order of the District Court (R. 5, 7-8) show that such claims total only \$6,589.68. We accept the latter figure as correct.

trustee, irrespective of the outcome of this litigation (R. 7).

An appeal taken by the State of New York from an order of the District Court entered June 23, 1939, was, upon stipulation of the parties, discontinued by order of the Circuit Court of Appeals entered February 7, 1940, and the case was remanded to the District Court (R. 6-7). As shown by the stipulation and order, the purpose of the remand was to permit the District Court to resettle its order in accordance with the intervening Social Security Act Amendments of 1939, effective August 10, 1939. The judgment of the Circuit Court of Appeals entered April 12, 1941 (R. 21), which this Court has consented to review, relates to the order of the District Court of July 15, 1940. (R. 3-4), after the remand.

Among the claims of the United States is one for taxes under Sections 801 and 802 (Title VIII) of the Social Security Act (R. 1). The State of New York contends that this claim is not entitled to priority under Section 64 (a) (4) of the Bankruptcy Act as a claim for taxes, on the ground that Title VIII imposes a tax on employees rather than on the employer, and that the liability imposed upon the employer to deduct the amount of the tax from the wages of the employees and to pay the tax does not constitute a liability for taxes (R. 10). The District Court held that this claim is entitled to priority as a tax claim. (R. 10-

11), and entered an appropriate order of distribution (R. 3-4). The Circuit Court of Appeals reversed, holding that this claim is not entitled to priority as a tax claim (R. 16-17).

Among the remaining claims are a claim of the United States under Section 901 (Title IX) of the Social Security Act and a claim of the State of New York for unemployment-compensation contributions under a law of that state. The remaining issues before this Court relate to the amount in which the Title IX claim of the United States may be allowed for the purpose of sharing in the distribution of the available assets, in view of the credit provisions contained in Section 902 of the Social Security Act, as amended. Both the District Court (R. 7-10) and the Circuit Court of Appeals (R. 18-20) held in accordance with the contentions of the United States with respect to this claim, which will be set forth at length in the Argument, Points II and III, *infra*.

SPECIFICATION OF ERRORS TO BE URGED IN NO. 238

The Circuit Court of Appeals erred:

1. In refusing to allow the claim of the United States for taxes levied under Title VIII of the Social Security Act as a claim for taxes legally due and owing by the bankrupt to the United States within the meaning of Section 64 (a) (4) of the Bankruptcy Act.

2. In reversing the judgment of the District Court for the Western District of New York grant-

ing priority in payment to the claim of the United States for taxes under Title VIII of the Social Security Act.

SUMMARY OF ARGUMENT

I

Section 801 of the Social Security Act requires that there shall be levied, collected and paid upon the income of every individual a tax equal to specified percentages of his wages. Section 802 (a) of that Act requires that the tax imposed by section 801 shall be collected by the employer of the taxpayer by deducting the amount of the tax from his wages and shall be paid to the United States by the employer. The employer is made liable for the payment of the tax irrespective of whether he has collected it from the employees and the Commissioner of Internal Revenue may assess and collect the tax as a tax from the employer. The obligation imposed upon the employer is indistinguishable from the obligation imposed upon the vendor by the New York City sales tax act, which was considered by this Court in *New York v. Feiring*, 313 U. S. 283. The decision of this Court in the *Feiring* case is sound and requires the reversal of the Circuit Court of Appeals in its holding that the claim of the United States under Sections 801 and 802 (a) of the Social Security Act is not provable under Section 64 (a) (4) of the Bankruptcy Act.

II

Section 902 of the Social Security Act, as amended, permits a credit to be taken against the tax imposed by Section 901 of that Act for amounts paid into unemployment compensation funds established under state laws. But in order for the credit to be granted, there must be strict compliance with the conditions of the Act. So far as here pertinent, these requirements are (1) that credit shall be allowed only for amounts actually paid into state unemployment compensation funds, and (2) that credit shall be taken against the amount of the tax imposed by Section 901 rather than against the amount of the distribution which may be made by a bankrupt estate with respect to the tax. In formulating a proper method of distributing the assets of a bankrupt employer, a third requirement, arising from Section 64 (a) (4) of the Bankruptcy Act, demands that the claim of the United States for taxes under Section 901 as finally allowed must share *pro rata* with other tax claims. The method of distribution urged by the United States and approved by both courts below fully satisfies these three requirements. The method of distribution urged by the State of New York violates at least two of the three requirements.

III

No part of the claim of the United States under Section 901 of the Social Security Act is for a

penalty. The total tax imposed is related to the burden laid upon the Federal Government by unemployment in the various states, and the amounts actually paid into a state fund in mitigation of the federal obligation are credited against the federal tax. Furthermore, the 1939 amendment to the Social Security Act upon which the state must rely for its claim expressly declares that "No part of the tax imposed by * * * Title IX * * * shall be deemed to be a penalty or forfeiture within the meaning of section 57 (j)" of the Bankruptcy Act.

ARGUMENT

I

THE LIABILITY IMPOSED UPON THE BANKRUPT BY SECTION 802 (A) OF THE SOCIAL SECURITY ACT TO PAY THE TAXES LEVIED UPON THE INCOMES OF ITS EMPLOYEES BY SECTION 801 OF THAT ACT IS A LIABILITY FOR TAXES WITHIN THE MEANING OF SECTION 64 (A) (4) OF THE BANKRUPTCY ACT

Section 801 of the Social Security Act (Appendix, *infra*, p. 27) provides, so far as pertinent here, that "there shall be levied, collected, and paid upon the income of every individual a tax" equal to specified percentages of the wages "received by him after December 31, 1936, with respect to employment." Section 802 (a) provides that the "tax imposed by section 801 shall be collected by the employer of the taxpayer, by de-

ducting the amount of the tax from the wages as and when paid," and that every "employer required so to deduct the tax is hereby made liable for the payment of such tax" (Appendix, *infra*, p. 27). See *Helvering v. Davis*, 301 U. S. 619, 634-635. The amount of taxes so imposed by Section 801, and made payable by the bankrupt by Section 802 (a), constitutes a part of the taxes claimed by the United States under Title VIII of the Social Security Act; the balance of that claim, representing taxes imposed under Section 804, is not in dispute.² The District Court held (R. 17-18) that the amounts for which the bankrupt was liable under Sections 801 and 802 (a) constituted "taxes" within the meaning of Section 64 (a) (4) of the Bankruptcy Act (Appendix, *infra*, p. 30), and that the claim for these amounts was therefore entitled to priority. The Circuit Court of Appeals reversed on this point (R. 27), holding that the obligation imposed upon the employer was for a "debt" rather than for taxes and did not form the basis of a claim entitled to priority under Section 64 (a) (4).

In reaching the conclusion that the obligation imposed upon the bankrupt by Sections 801 and 802 (a) did not constitute a liability for taxes, the Circuit Court of Appeals relied, in part, upon its own decision in *In re National Studios*, 118 F.

² The record on appeal does not indicate the exact amount of taxes claimed under Title VIII or the amount of such taxes here in dispute (Cf. R. 1 with R. 7-8).

(2d) 329. (R. 17.) But that decision was subsequently reversed by this Court, *sub nom.*, *New York v. Feiring*, 313 U. S. 283, and we submit that the decision of this Court in the *Feiring* case requires reversal here.

In the *Feiring* case, this Court held that the claim of the City of New York for a city sales tax against a bankrupt vendor of personal property was entitled to priority under Section 64 (a) (4) of the Bankruptcy Act. The taxing statute there involved, as the opinion points out (313 U. S. at pp. 286-287), laid a tax upon receipts from retail sales of tangible personal property in New York City and required the vendor to charge the vendee with the amount of the tax separately from the sales price and to collect the tax from him. The vendee, in turn, was commanded to pay the tax to the vendor for the account of the City of New York. The vendor was required to make periodic returns of his receipts and the taxes payable and to pay the tax to the City Comptroller. In the event that the vendor failed to collect the tax from the vendee, the statute made it the duty of the vendee to file a return and to pay the tax directly to the Comptroller. By Section 8 of the statute, machinery was provided for the collection of the tax from either the vendor or the vendee. The opinion of the Court also referred (p. 287) to the fact that in construing the foregoing provisions the New York Court of Appeals had held that while the Comptroller might proceed to collect the

tax from the vendee if he had not paid it to the vendor, the duty to pay the tax was also laid upon the vendor whether he had in fact collected it and regardless of his ability to collect it from the vendee. From these circumstances, this Court concluded (p. 287):

The statute thus contains provisions which in its normal operation are calculated to enable the seller to shift the tax burden to the purchaser, * * *. But it is plain that both the vendor and the vendee are made liable for payment of the tax *in invitum* without regard to those provisions by which the seller may shift the incidence of the tax to the buyer and the tax may be summarily collected by distraint of the property of either the seller or the buyer. A pecuniary burden so laid upon the bankrupt seller for the support of government, and without his consent, thus has all the characteristics of a tax entitled to priority of payment in bankruptcy within the meaning of § 64 of the Bankruptcy Act. * * *

It will be seen that the obligation imposed upon employers by Sections 801 and 802 (a) of the Social Security Act is strictly analogous to the burden imposed upon vendors by the New York City sales tax. The employer is required by Section 802 (a) to collect the tax from the employees, just as the vendor in New York City is required to collect the tax from the purchasers by billing them separately for the amount of the tax. The employer, equally with the vendor, is made liable for

the payment of the tax irrespective of whether he has collected it from another.³ The Commissioner of Internal Revenue may assess the tax against the employer and, as in the case of the New York City vendor, may recover the tax from him by the summary procedures available to the sovereign for the collection of revenue. Sections 806 and 807 (c) of the Social Security Act; Article 505 of Treasury Regulations 91, promulgated under Title VIII of the Social Security Act. (Appendix, *infra*, pp. 27-28, 31.) From this comparison, it seems plain that the obligation imposed upon an employer by Sections 801 and 802 (a) of the Social Security Act, no less than the obligation placed upon the vendor by the New York City sales tax, is a "pecuniary burden * * * laid upon the bankrupt * * * for the support of government, and without his consent" and "thus has all the characteristics of a tax entitled to priority of payment in bankruptcy within the meaning of § 64 of the Bankruptcy Act." 313 U. S. at p. 287.

In reaching a contrary conclusion the Circuit Court of Appeals erred, we submit, in misapplying a distinction which in other circumstances is valid. The court drew a distinction between a taxpayer and a tax collector, holding that the tax as such was laid upon the employees and that the

³ As the Circuit Court of Appeals correctly pointed out (R. 17), the record does not show that the bankrupt ever deducted the taxes imposed by Section 801 from the wages of its employees.

employer was made merely "a compulsory tax collector * * * liable only as an agent bound to pay" (R. 17). The distinction so drawn between the person upon whom by force of the taxing statute the economic burden of the tax is imposed and the compulsory tax collector, who is required to collect the amount of the tax from such person and pay it over to the governmental authority, appears to be a sound one as applied, for example, to suits for refund of taxes paid. See *Regents of University System of Georgia v. Page*, 81 F. (2d) 577, 579, 580, 582, 93 F. (2d) 887, 889 (C. C. A. 5th), affirmed in this respect *sub nom*, *Allen v. Regents*, 304 U. S. 439, 445-449; *Shannopin Country Club v. Heiner*, 2 F. (2d) 393 (W. D. Pa.). This is true since the public interest requires that, absent express authorization to the contrary, refund of taxes erroneously paid should be made only to the person upon whom the statute has imposed the burden of the tax. Similarly, the distinction between taxpayer and tax collector may be useful in determining whether a forbidden tax burden is laid upon interstate commerce (*McGoldrick v. Berwind-White Co.*, 309 U. S. 33, 43-44) or upon a national bank (*Colorado Bank v. Bedford*, 310 U. S. 41, 52-53). But wholly different considerations are involved in applying Section 64 (a) (4) of the Bankruptcy Act. The public interest expressed in that section, manifestly, is the interest in securing for governments, both state and federal, the monies essential for their continu-

ance. When viewed against the background of the Bankruptcy Act, the distinction between taxpayer and tax collector in these circumstances should give way to the controlling fact that the bankrupt is legally liable for payment of amounts imposed as a tax. Long before the *Feiring* case, this Court had brushed aside technical refinements and given a liberal interpretation to the expression "taxes" as used in the Bankruptcy Act. "Generally speaking," this Court had said, "a tax is a pecuniary burden laid upon individuals or property for the purpose of supporting the Government." *New Jersey v. Anderson*, 203 U. S. 483, 492; cf. *United States v. Updike*, 281 U. S. 489, 494. Both of these cases were referred to by this Court in the *Feiring* opinion.

The decision in *New York v. Feiring, supra*, is thus sound in principle and indistinguishable from the instant case. It would clearly seem to require the reversal of the holding of the Circuit Court of Appeals that the liability imposed upon the bankrupt by Section 801 and Section 802 (a) of the Social Security Act is not entitled to priority under Section 64 (a) (4) of the Bankruptcy Act.

II

THE COURTS BELOW PROPERLY APPLIED THE CREDIT PROVISION OF SECTION 902 OF THE SOCIAL SECURITY ACT, AS AMENDED, IN ORDERING A FINAL DISTRIBUTION

The remaining issues in controversy concern the claim of the United States under Section 901 of

Title IX of the Social Security Act. (Appendix, *infra*, p. 28.) We consider, first, the state's contention that the District Court failed to allow a proper credit against this Title IX claim and thereby awarded that claim an excessive share of the available assets. The method of computation applied by the District Court (R. 7-8) was approved by the Circuit Court of Appeals (R. 18-20).

Section 902 of the Social Security Act, both as originally enacted and as amended, allows a credit against the tax imposed by Section 901 of that Act in an amount up to but not exceeding 90% of the federal tax for contributions paid into unemployment compensation funds under state laws. (Appendix, *infra*, pp. 28-29.) But the credit is carefully limited and may be allowed only if the requirements expressly provided by the Social Security Act are satisfied. See *Steward Machine Co. v. Davis*, 301 U. S. 548, 574-576, 593-596. The requirements pertinent here are set forth in Section 902. As originally enacted, Section 902 permitted the taxpayer a credit of not exceeding 90% of the federal "tax" for "contributions, with respect to employment during the taxable year, paid by him (before the date of filing his return for the taxable year) into an unemployment fund under a State law." As amended by the Social Security Act Amendments of 1939, effective August 10, 1939, Section 902 of the Social Security Act provides:

SEC. 902. (a) Against the tax imposed by section 901 of the Social Security Act for the calendar year 1936, 1937, or 1938, any taxpayer shall be allowed credit for the amount of contributions, with respect to employment during such year, paid by him into an unemployment fund under a State law—

(3) Without regard to the date of payment, if the assets of the taxpayer are, at any time during the fifty-nine-day period following such date of enactment, in the custody or control of a receiver, trustee, or other fiduciary appointed by, or under the control of, a court of competent jurisdiction.

From these provisions, it will be seen that under the original Section 902, as applied to the instant case, no credit whatsoever could be allowed for amounts distributed to the State of New York under its unemployment compensation act, since such payments were not made before January 31, 1938, the date fixed for filing the federal return for the year 1937 (Section 905 (b) of the Social Security Act).⁴ It will likewise be noted that by virtue of the 1939 amendment, credit may be allowed, since as applied to this case the *date* of payment into the state fund is no longer a decisive factor. But both as originally enacted and as

⁴ The Title IX claim is for wages paid during 1937. See the first opinion of the District Court, 28 F. Supp. 428.

amended, Section 902 requires (1) that the credit shall be allowed against the "tax" imposed by Title IX, and (2) that the credit shall be allowed only for amounts actually "paid" into the state fund. Any proper method of distribution must obviously comply with these two requirements.

A third requirement which must be met stems from the Bankruptcy Act. Under Section 64 (a) (4) of that Act, taxes legally due and owing by the bankrupt to the United States and to the state must share pro rata. *Missouri v. Ross*, 299 U. S. 72.

The amount in the hands of the trustee for final distribution on the various tax claims is \$3,053.20 (R. 3). The amounts of the various tax claims entitled to priority under Section 64 (a) (4) of the Bankruptcy Act are as follows (R. 7-8):

Claim of the United States under Title IX of the Social Security Act.....	\$3,400.49
Remaining tax claims of the United States.....	3,189.19
Claims of the State of New York for unemployment compensation contributions.....	3,305.82
Remaining tax claims of the State of New York.....	2,720.80

In these circumstances, as will be shown in detail in footnote 6, *infra*, the proper distribution percentage will be found to be 25.967%.⁵ Using this

⁵ This percentage is computed upon the basis that the claim of the United States under Sections 801 and 802 (a) of the Social Security Act is entitled to priority under Section 64 (a) (4) of the Bankruptcy Act (*supra*, pp. 8-14) and is, therefore, entitled to share pro rata with the other tax claims. If the Court disagrees with our position in Point I in this respect, the percentage figure will, of course, be increased. The method of computation, however, would remain the same.

percentage, \$858.42 will be available for payment on the state's claim of \$3,305.82 for unemployment compensation contributions. When this dividend is allowed as a credit against the claim of the United States for Title IX taxes, the latter claim is reduced to \$2,542.07. Applying the percentage figure to the Title IX claim, as so reduced, \$660.10 will be available for payment of it. Again applying the same percentage figure to the remaining claims of the United States and of the state, the amounts of \$828.14 and \$706.53, respectively, will be found available for the payment of these claims. The total of the four distributions set forth will be found to equal the total available assets of \$3,053.19.

The District Court approved this method of distribution and applied the percentage figure we have used (R. 8). The Circuit Court of Appeals approved the method (R. 20) but could not apply the same percentage figure because of its decision on the preliminary question discussed in Point I that the Title VIII taxes were not entitled to priority.

This method of computation, we submit, fully satisfies the three requirements which must be met. (1) The amount of \$858.42 is properly allowed as a credit against the Title IX claim because that amount will actually be paid to the state upon its claim for unemployment-compensation contributions (and does not exceed 90% of the federal claim). (2) The amount of \$858.42

so allowed as a credit is properly taken against the total amount of the Title IX claim—i. e., against the amount of the “tax imposed by Section 901 of the Social Security Act.” (3) All of the tax claims, including the claim under Title IX, as reduced by proper credit, share the assets of the estate in equal proportions. Both mathematically and legally, therefore, the distributions so computed are proper. It follows, likewise, that any system of computation which results in different amounts to be distributed upon the respective claims cannot satisfy the statutory requirements.

While the method of arriving at the applicable percentage of 25.967 is primarily a mathematician's rather than a lawyer's problem, the procedure followed is nevertheless pertinent. Since the amount of the Title IX claim to be finally used as a basis for distribution is dependent upon the amount of the payment to be made upon the claim of the state for unemployment compensation contributions, and since the latter, in turn, is necessarily dependent upon the amount of the Title IX claim to be finally used, the two amounts are variables dependent upon each other. Hence, it is necessary to translate the amounts involved into an equation, which can then be solved by recognized algebraic methods.*

* Let A=amount of State's claim for unemployment compensation contributions (\$3,305.82). Let B=total *gross* amount of all other tax claims (\$3,400.49 Title IX taxes, plus \$3,189.19 other Federal taxes, plus \$2,720.80 other state taxes,

It is unnecessary to analyze in detail the alternative formula submitted by the state ~~since~~, for, as we have seen, the method approved by the courts below fully satisfies the statutory requirements. It may be observed, however, that the method offered by the state in fact violates at least two of the three essential requirements. (1) The state

making a total of \$9,310.48). Let T = total assets available for distribution (\$3,053.19). Since only a percentage of the claims can be satisfied, let x = percentage. But under Title IX, the amount of the *net* Federal claim will be the tax imposed thereunder (\$3,400.49) minus the credit for the amount actually distributed to the state, i. e., minus xA . Accordingly the total *net* amount of all tax claims, exclusive of the state's claim for unemployment compensation contributions, is $B - xA$. And the total of all the net claims of both the state and the United States is equal to $A + B - xA$.

Therefore, $T = x(A + B - xA)$,

$$T = x(A + B) - x^2A,$$

$$Ax^2 - (A + B)x + T = 0.$$

This is a quadratic equation in the general form, $ax^2 + bx + c = 0$, which is solved by the recognized formula $x = \frac{-b \pm \sqrt{b^2 - 4ac}}{2a}$. Applying that formula here, the solution becomes:

$$x = \frac{-[-(A + B)] \pm \sqrt{[-(A + B)]^2 - 4AT}}{2A},$$

$$x = \frac{A + B \pm \sqrt{(A + B)^2 - 4AT}}{2A}$$

As is the case in every quadratic equation there are two solutions depending upon whether the "+" or the "-" is used before the square root. But since the use of the "+" would give a value for x in excess of 100% in the circumstances of this case, it is obvious that the "-" is the only correct alternative that can be used here.

Accordingly, by substituting the known values for A , B , and T , the value of x is found to be 25.967%.

contends that the bankrupt should be credited with 90% of the Title IX claim *regardless* of the amount paid into the state fund. (2) Under the state's formula, credit is taken not against the Title IX claim, but against the *distributions* made upon that claim. Neither as originally enacted nor as amended does Section 902 sanction this method of computing the allowable credit.

We submit, therefore, that the courts below properly applied the credit provisions of Section 902 and that their action in this respect should not be disturbed.

III

NO PART OF THE CLAIM OF THE UNITED STATES UNDER TITLE IX OF THE SOCIAL SECURITY ACT IS A PENALTY WITHIN THE MEANING OF SECTION 57 (J) OF THE BANKRUPTCY ACT

As indicated above, the State of New York contends that a credit in the amount of 90% of the federal claim under Title IX—that is, in the amount of \$3,060.44—is allowable against the Title IX claim, whereas under the computation set forth above, the credit against the Title IX claim is limited to \$858.42, the amount actually available for distribution on the state's claim for unemployment compensation contributions. From this the state contends that the increase in the amount of the Title IX claim finally used as a basis of distribution which is attributable to the allowance of a credit of \$858.42 rather than a credit of \$3,060.44 represents a penalty

awarded to the United States. Otherwise expressed, the state contends that the Title IX claim should have been finally allowed for \$340.05 (representing 10% of the total claim of \$3,400.49) rather than for \$2,542.07 (the amount allowed in the computation) and that the difference constitutes a penalty, which can not be allowed under Section 57 (j) of the Bankruptcy Act. Both the District Court (R. 9-10), and the Circuit Court of Appeals (R. 18-20) correctly, we submit, rejected that contention.

Title IX imposes a tax but allows a credit of not to exceed 90% for similar taxes paid to any state. Thus, the portion of the claim in this case in excess of 10% is not an amount which has been added to the tax but is a portion of the tax itself. The state's contention is in essence that the withholding of a credit amounts to the imposition of a penalty. Since the credit is a gratuity which Congress is free to grant or withhold, the state's position is untenable unless the condition attached to the credit converts it into a penalty.

We are not dealing here with an exaction imposed in order to compel compliance with requirements in which the Federal Government has no proper interest. See *Steward Machine Co. v. Davis*, 301 U. S. 548, 586-590; cf. *United States v. Constantine*, 296 U. S. 287, 295-296. This Court has already pointed out that the total amount of the federal tax imposed by Title IX bears a relationship to the demands upon the Federal Gov-

ernment for unemployment relief in the various states in the absence of provision by the states for unemployment compensation and that the allowance of the credit is a proper recognition that in those states which administer their own systems of unemployment relief the demands upon the Federal Treasury may be *pro tanto* reduced. *Steward Machine Co. v. Davis, supra*, pp. 586-590; *Carmichael v. Southern Coal Co.*, 301 U. S. 495, 525-526. Although the Court was here referring broadly to the interest of the Federal Government in the establishment of state unemployment compensation systems, its remarks apply equally to a situation, such as the present, where the taxpayer does not in fact discharge his obligations to a state fund. The opinion in the *Steward Machine* case observed (p. 589) that "fulfilment of the home duty will be lightened and encouraged by crediting the taxpayer upon his account with the Treasury of the nation *to the extent that his contributions* under the laws of the locality have simplified or diminished the problem of relief and the probable demand upon the resources of the fisc." [Italics supplied.] This is palpably sound since the drain upon the Federal Treasury will be reduced not by the amount of the state's claim for unemployment compensation contributions but only by the amount actually paid into the state fund. These considerations prove groundless the state's contention that where the taxpayer is bankrupt any amount for which the Title IX claim is

allowed in excess of 10% of that claim constitutes a penalty, regardless of the amounts actually paid into the state fund.

The state will doubtless point out that, using the basis of computation approved by the courts below, the Title IX claim will secure a distribution in the amount of \$660.10, whereas, if the estate were solvent and if the state claim were paid in full, the Title IX claim would secure a distribution of only \$340.05. This is true since the Title IX claim is reduced only to \$2,542.07 after allowance of the credit, while if the estate were solvent and the claim of the State of New York for unemployment-compensation contributions were paid in full, the amount of the Title IX claim would be reduced upon allowance of proper credit to \$340.05. But here it is impossible *on any method of computation* for the bankrupt fully to discharge its obligation under the state unemployment-compensation law. So far as the bankrupt is concerned, the cooperative scheme contemplated by the Social Security Act has broken down. Furthermore, while the state's method of computation would result in a somewhat increased distribution to its own unemployment-compensation fund, the aggregate amount received by both federal and state governments under the state's computation would be substantially reduced. Thus, the state would distribute \$1,056.09 to its own unemployment-compensation fund and would allow the Federal Government \$108.67 on its Title IX claim, a

total of \$1,164.76. Under the computation approved by the courts below, the state fund will receive \$858.42 and the Title IX claim will receive \$660.10, an aggregate of \$1,518.52. It is obviously inconsistent with the policy of the Social Security Act that the credit provisions of that Act should be applied in the case of a bankrupt employer to minimize the total amount collected for relief of unemployment.⁷ The state's method of computation nevertheless achieves this result.

Section 902 (i) of the 1939 amendments to the Social Security Act has removed any doubt upon the point here in issue, for Congress has expressly provided that no part of the tax imposed by Title IX of the Social Security Act, whether or not the taxpayer is entitled to a credit against such tax, shall be deemed to be a penalty or forfeiture within the meaning of Section 57 (j) of the Bankruptcy Act. (Appendix, *infra*, p. 30.) Even if prior to this amendment any part of the claim under Title IX could properly have been considered a penalty within the meaning of the Bankruptcy Act, the amendment has set the mat-

⁷As this Court pointed out in the *Steward Machine* case, while the amounts collected under Title IX are covered into the Treasury "like internal-revenue collections generally" (301 U. S. at p. 574), the amounts so collected may be taken as a measure of the amount which the Federal Government will be called upon to expend in order to alleviate unemployment (301 U. S. at pp. 588-589). The Federal Government also appropriates sums to the states for the administration of their unemployment compensation laws. Section 301 of the Social Security Act.

ter at rest. There can be no question that the provision referred to is applicable to the instant case; the state, as we have seen, must base its claim for credit upon paragraphs (a) (3) of the same section.* Nor does Congress lack constitutional authority to give priority in bankruptcy to what would normally be considered a penalty. Under Section 3466 of the Revised Statutes, this Court has awarded priority to penalties due the United States. *Spokane County v. United States*, 279 U. S. 80, 86, 93.

CONCLUSION

For the above reasons, it is submitted that the judgment of the Circuit Court of Appeals should be reversed with respect to the claim of the United States under Sections 801 and 802 (a) of the Social Security Act and should otherwise be affirmed.

Respectfully submitted.

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* Furthermore, the legislative history of this enactment shows that it was not intended to effect a substantive change in the prior law, but was designed merely to set at rest the question presented in numerous pending cases. S. Rep. No. 734, 76th Cong., 1st Sess., p. 91.

APPENDIX

Social Security Act, c. 531, 49 Stat. 620:

SECTION 801. In addition to other taxes, there shall be levied, collected, and paid upon the income of every individual a tax equal to the following percentages of the wages (as defined in section 811) received by him after December 31, 1936, with respect to employment (as defined in section 811) after such date:

(1) With respect to employment during the calendar years 1937, 1938, and 1939, the rate shall be 1 per centum.

* * * *

(U. S. C. Supp. V, Title 42, Sec. 1001.)

SEC. 802. (a) The tax imposed by section 801 shall be collected by the employer of the taxpayer, by deducting the amount of the tax from the wages as and when paid. Every employer required so to deduct the tax is hereby made liable for the payment of such tax, and is hereby indemnified against the claims and demands of any person for the amount of any such payment made by such employer.

* * * *

(U. S. C. Supp. V, Title 42, Sec. 1002.)

SEC. 806. If more or less than the correct amount of tax imposed by section 801 or 804 is paid or deducted with respect to any wage payment and the overpayment or underpayment of tax cannot be adjusted under section 802 (b) or 805 the amount of the overpayment shall be refunded and

the amount of the underpayment shall be collected, in such manner and at such times (subject to the statutes of limitations properly applicable thereto) as may be prescribed by regulations made under this title. (U. S. C. Supp. V, Title 42, Sec. 1006.)

SEC. 807. * * *

(c) All provisions of law, including penalties, applicable with respect to any tax imposed by section 600 or section 800 of the Revenue Act of 1926, and the provisions of section 607 of the Revenue Act of 1934, shall, insofar as applicable and not inconsistent with the provisions of this title, be applicable with respect to the taxes imposed by this title. * * *

(U. S. C. Supp. V, Title 42, Sec. 1007.)

SECTION 901. On and after January 1, 1936, every employer (as defined in section 907) shall pay for each calendar year an excise tax, with respect to having individuals in his employ, equal to the following percentages of the total wages (as defined in section 907) payable by him (regardless of the time of payment) with respect to employment (as defined in section 907) during such calendar year:

(1) With respect to employment during the calendar year 1936 the rate shall be 1 per centum;

(2) With respect to employment during the calendar year 1937 the rate shall be 2 per centum;

(3) With respect to employment after December 31, 1937, the rate shall be 3 per centum.

(U. S. C. Supp. V, Title 42, Sec. 1101.)

SEC. 902. The taxpayer may credit against the tax imposed by section 901 the amount of contributions, with respect to employment during the taxable year, paid by him (before the date of filing his return for the taxable year) into an unemployment fund under a State law. The total credit allowed to a taxpayer under this section for all contributions paid into unemployment funds with respect to employment during such taxable year shall not exceed 90 per centum of the tax against which it is credited, and credit shall be allowed only for contributions made under the laws of States certified for the taxable year as provided in section 903;
(U. S. C. Supp. ~~V~~, Title 42, Sec. 1102.)

Social Security Act Amendments of 1939, c. 666, 53 Stat. 1360, 1399:

SEC. 902. (a) Against the tax imposed by section 901 of the Social Security Act for the calendar year 1936, 1937, or 1938, any taxpayer shall be allowed credit for the amount of contributions, with respect to employment during such year, paid by him into an unemployment fund under a State law—

* * * * *

(3) Without regard to the date of payment, if the assets of the taxpayer are, at any time during the fifty-nine-day period following such date of enactment, in the custody or control of a receiver, trustee, or other fiduciary appointed by, or under the control of, a court of competent jurisdiction.

* * * * *

(i) No part of the tax imposed by the Federal Unemployment Tax Act or by title IX of the Social Security Act, whether or not the taxpayer is entitled to a credit against such tax, shall be deemed to be a penalty or forfeiture within the meaning of section 57j of the Act entitled "An Act to establish a uniform system of bankruptcy throughout the United States", approved July 1, 1898, as amended.

(U. S. C. Supp. V, Title 42, Sec. 1102 Note.)

Bankruptcy Act of July 1, 1898, c. 541, 30 Stat. 544, as amended by Act of June 22, 1938, c. 575, 52 Stat. 840:

SEC. 57. PROOF AND ALLOWANCE OF CLAIMS.—* * *

(j) Debts owing to the United States or any State or subdivision thereof as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued thereon according to law.

(U. S. C. Supp. V, Title 11, Sec. 93.)

SEC. 64. DEBTS WHICH HAVE PRIORITY.—

a. The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be

* * * (4) taxes legally due and owing by the bankrupt to the United States or any State or any subdivision thereof: *Provided*, That no order shall be made for the payment of a tax assessed against any

property of the bankrupt in excess of the value of the interest of the bankrupt estate therein as determined by the court: *And provided further*, That, in case any question arises as to the amount or legality of any taxes, such question shall be heard and determined by the courts; * * *

(U. S. C. Supp. V, Title 11, Sec. 104.)

Treasury Regulations 91, promulgated under Title VIII of the Social Security Act:

ART. 505. *Assessment of underpayments*.—If any tax is not paid to the collector when due, the Commissioner may, as the circumstances warrant, assess the tax (whether or not the underpayment is otherwise adjustable) or afford the employer opportunity to adjust the underpayment pursuant to article 502 or 503. Unpaid employers' tax or employees' tax may be assessed against the employer. Employees' tax not collected by the employer may also be assessed against the employee. The unpaid amount, together with interest and penalty, if any, will be collected, pursuant to section 3184 of the United States Revised Statutes and other applicable provisions of law, from the person against whom the assessment is made. If any amount of an assessment has been previously reported and paid to the collector as an adjustment or otherwise, the person against whom the assessment is made is privileged to file with the collector a claim for abatement of such amount, together with interest and penalty thereon if included in the assessment. If an employer pays employees' tax pursuant to an

assessment against him without an adjustment having been made pursuant to article 502, reimbursement is a matter to be settled between the employer and the employee. See article 602, relating to interest, and article 603, relating to penalty for failure to pay an assessment after notice and demand. See also article 601, relative to jeopardy assessments.